UNITED
NATIONS

E

Economic and Social Council

Distr.
LIMITED

E/C.10/AC.3/1991/L.3/Add.5
11 March 1991

ORIGINAL: ENGLISH

COMMISSION ON TRANSNATIONAL CORPORATIONS
Intergovernmental Working Group of
Experts on International Standards
of Accounting and Reporting
Ninth session
5-15 March 1991
Agenda item 5

ADOPTION OF THE REPORT OF THE GROUP ON ITS NINTH SESSION

Draft report

Addendum

Rapporteur: G. G. M. BAK (Netherlands)

PROGRAMME OF WORK OF THE INTERGOVERNMENTAL WORKING GROUP OF EXPERTS ON INTERNATIONAL STANDARDS OF ACCOUNTING AND REPORTING

B. Discussion of accounting and reporting issues identified during the eighth session

3. Accounting and reporting during and after the transition from State to private enterprises

1. At its 7th and 8th meetings, on 8 March 1991, the Group had before it the report of the Secretary-General containing an overview of accounting and reporting during and after the transition from public to private enterprises (E/C.10/AC.3/1991/6). In the opinion of many of the experts, the report had achieved its modest aim of summarizing for the Group the objectives of privatization and the economic, financial and social conditions which influenced the choice of various financing techniques. That background information had set the stage for the discussion of accounting and valuation problems that could arise during the process. The representative of the Centre suggested that the study of those problems could be enriched through case studies of countries that had implemented such programmes: during the session, a number of experts had informed

the Group about the experience of their countries and suggested that they be included in such case studies. It was mentioned that a distinction should be made between privatization of an entire economy or of a large part of an economy and privatization of one or more undertakings within an existing market economy.

2. One expert, in commenting on valuation methods, said that they should be considered as "objective" rather than "subjective", since they should be based on scientific criteria. He wanted to know who should appraise and evaluate enterprises to be privatized. In some countries, the task was given to special banks; perhaps it should be given to special professionals. The observer for the International Assets Valuation Standards Committee defined the "value of assets" as the amount a business would lose if it were deprived of those assets. He said that the value of property was equal to the sum of the value of land plus the gross replacement value of plant and equipment minus obsolescence. However, the appraiser must also take into consideration the profitability of the enterprise.

3. Another expert was of the opinion that the overriding method of valuation was the present value method since the entire operation had to be valued, not just the assets. The subsection of the report on accounting issues had underestimated the difficulties since the use of the present value method was closely linked with management accounting. In order to use the present value method, a good management system had to be in place. Therefore, many accounting problems arose because of the lack of good systems to track expenses and revenues. That lack ultimately made it difficult to value the operation using the present value method. Therefore, there was a strong link between valuation and management accounting systems.

4. A number of experts pointed out that in order to sell an enterprise to either domestic or foreign investors, it was necessary to have good accounting information. It was noted that accounting problems often started at an earlier stage, when a public department became a public corporation. Therefore, any future work on that topic should take into consideration the restructuring of bookkeeping accounts and systems and the preparation of accounting information.

5. The observer for the International Confederation of Free Trade Unions (ICFTU) said that valuation of an enterprise was particularly difficult when that enterprise had to be restructured and often the valuation depended on local economic conditions. The valuation of enterprises in the former German Democratic Republic had been affected by the economic situation after unification with the Federal Republic of Germany. Many such enterprises were not competitive, could not be restructured and would be closed. It was estimated that half the labour force would be unemployed as a result. The expert from Germany said that the privatization process was indeed under way in his country. A state-owned trust company, currently owned all the former kombinate and state-owned enterprises. Its task was to privatize, restructure or liquidate enterprises, which could not be run successfully under competitive conditions. To diminish the dilemma between privatization and restructuring, it was decided to give priority to privatization as soon as possible. The necessary restructuring would occur under the new private owner. Thus far, only 700 of the 8,000 to 10,000 enterprises had been sold. The privatization process was further complicated by the process of re-privatization: a general reassignment of property rights to the people whose property had

previously been expropriated. That task also included the restitution of enterprises to their former owners. Political priority was given to the restitution but, given the necessity to create employment through economic growth, restitution could be overruled. In that case, compensation had to be paid to the former owners. The number of requests for restitution amounted to about 12,000, about 3,000 of which had been settled. One interesting accounting problem had arisen in the case of a number of enterprises that had previously been expropriated and then merged with other enterprises. The task was to split off the assets and liabilities so that they could be reassigned. He agreed that the choice of valuation methods depended on the situation. It seemed, however, that the most important factor influencing the final selling price was bargaining strength.

6. Experts from developing countries raised a number of issues that were of concern to those countries that had undertaken privatization programmes or would do so. First, there was the question why should a Government sell profitable enterprises; secondly, who would buy unprofitable enterprises. Many enterprises had been in the private sector in the first place and had been taken over by the Government because they were not viable. It was doubtful whether anyone would want to buy them. Very often in order to sell them, the Government had to restructure them and reduce the labour force. A third issue was the high cost of such sales which, in some instances, ranged from 2.5 per cent to 13 per cent of the final sales revenues. The last question was how could the right price be set to avoid giving windfall gains?

7. One expert said that international organizations required the adoption of privatization programmes in some developing countries as a precondition for aid. Consequently, the Governments of those countries were forced to sell the profitable enterprises and were left with the unprofitable ones. That sometimes resulted in windfall gains to the private sector, while the Government faced continued deficits. It was obvious that guidelines were needed on when to privatize. Another expert said that there seemed to be an implicit assumption that only public enterprises ran at a deficit. That was not always true; in his country, only 50 per cent of the private enterprises were in deficit.

8. An expert from a developed country replied to a number of questions raised by experts from developing countries. In explaining why a Government would ever sell a profitable enterprise he noted that the existence of a profit did not necessarily indicate efficiency but could indicate the existence of a monopoly. In that case, the Government would need to ensure that there was some regulatory control after privatization. In some instances, the Government sold profitable enterprises because it felt that it should not compete with the private sector. With regard to the determination of the right share price, it was extremely difficult to pick the correct one and Governments were criticized if the price set appeared low in hindsight, but they would also have been criticized had the price been set too high and the share issue a failure. Where share offerings were large, the Government usually priced them conservatively in order to ensure that all the shares were sold. The cost of sales was sometimes relatively high because of the many steps Governments were obligated to take in order to make sure the process was fair.

9. Another expert said that consideration of the topic was very timely and that transition to a market economy should be accelerated. In his country, the privatization law had been implemented in 1990. However, it would take at least 100 years to sell state enterprises, owing to the lack of domestic savings. Therefore, foreign direct investment was needed.

10. The Group decided that work in that area should be continued and that it should be enriched by country case studies. The main objective of further study would be to clearly identify the accounting problems and to indicate how they had been or could be solved.

D. Further steps to be taken in relation to the development of the comprehensive information system

11. At its 8th meeting, on 8 March 1991, the Group considered further steps to be taken in relation to the development of the comprehensive information system. It had before it the report of the Secretary-General containing a description of the databases available in that system (E/C.10/AC.3/1991/8). A representative of the Centre described the overall structure of the Centre's information and database systems. The Group raised a number of questions about the number of user requests and the accuracy of information. The Centre's response with regard to the number and type of users is provided in the table.

Requests by category and type of requestor, 1990

	Requests made by													
	Governments		Intergovernmental organizations		Trade union organizations		Business organizations		Academic institutions		Media and public interest groups		Total	
	No.	Percentage of category	No.	Percentage of category	No.	Percentage of category	No.	Percentage of category	No.	Percentage of category	No.	Percentage of category	No.	Percentage
Developing countries	375	51	18	5	31	15	25	12	149	22	94	24	692	27
Developed market economy countries	251	34	52	13	135	66	178	86	412	61	158	40	1 186	45
Eastern Europe	111	15	--	--	24	11	5	2	74	11	33	8	247	9
International organizations	-	-	320	82	18	8	--	--	41	6	106	27	485	18
Total	737	100	390	100	208	100	208	100	676	100	391	100	2 610	100

A dash (--) indicates that the amount is nil.

A hyphen (-) indicates that the item is not applicable.

/...

E. Accounting and reporting issues arising out of the future code of conduct on transnational corporations

12. At its 8th meeting, on 8 March 1991, the Group considered accounting and reporting issues arising out of the future code of conduct on transnational corporations. A representative of the Centre informed the Group of the latest developments in the negotiations on the code of conduct. There were two major concerns. First, the language of the text was considered by some to be outdated, since parts of it had been drafted many years before. Secondly, since the code would be in the form of recommendations that were not legally binding, the implementation process would have to be carefully reviewed. The negotiations were in the hands of the President of the General Assembly, who would soon be organizing informal consultations. If the code were endorsed by the General Assembly at its forty-sixth session, it would establish a framework for foreign direct investment. He noted that whereas trade was governed by the General Agreement on Tarriffs and Trade and financed by the International Monetary Fund (the Bretton Woods agreement), there was no instrument balancing the rights and responsibilities in foreign direct investment. He informed the Group that the latest developments in the code of conduct were contained in document E/C.10/1991/8.